



Risk Adjustment for Employer-sponsored Health Care

December 13, 2011

Introduction

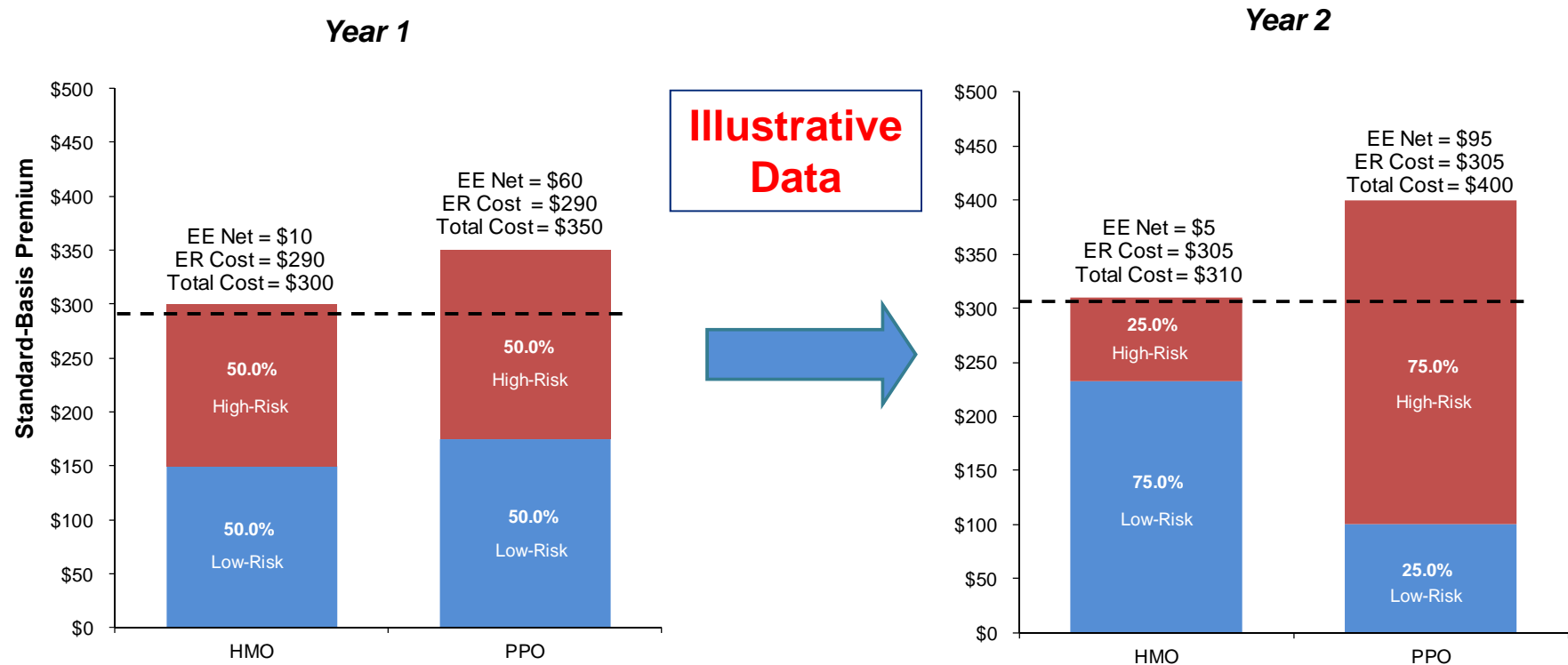
What is Risk Adjustment?

- Risk adjustment is the process of adjusting health plan payments, health care provider payments and individual or group premiums to reflect the health status of members.
- Risk adjustment is typically a two-step process:
 - Risk assessment – measuring the risk (represented by predicted overall claim dollars) of each person in a group relative to the average risk
 - Premium/payment adjustment – modifying of premiums/payments to reflect differences in risk

Why do employers use Risk Adjustment?

- Maintains choice of plan types for employees by improving sustainability (preventing a "death spiral")
- Encourages health plans to submit competitive quotes in a stable environment over time
- Reduces incentive for insured health plans to load premiums for potential adverse selection
- Fosters health plan competition based on efficiency and quality rather than risk selection
- Allows employee contributions to be set so that cost differences across options reflect differences in plan design, networks, and health plan efficiency rather than the health status differences of members selecting those options

Preventing a “Death Spiral” using Risk-Adjustment



- Higher-risk employees tend to elect the more expensive PPO plan in order to secure greater provider choice
- This causes the health plan to increase the price of the PPO to reflect anticipated adverse-selection by these higher risk members, resulting in members with healthier risk to migrate to the HMO
- While the cost of the HMO increases slightly, the cost of the PPO increases dramatically
- This cycle is self-reinforcing; each year more migration occurs and the price disparity widens
- Ultimately, the PPO could be priced out of existence, eliminating that choice

Components of Risk Adjustment Measurement

Demographic and Health Status Factor

- Age
- Gender
- Health Status (can be measured using):
 - Pharmacy claims
 - Medical diagnosis from fee-for-service or encounter data
 - Other claims data (such as diagnostic testing)

Geographic Adjustment

- Geographic adjustment is used to reflect regional differences in providers costs
 - Can result from provider leverage in the market place, differences in provider practice patterns, general cost of living differences, and/or other items

Coverage Category Variation Adjustment

- Reflects relative differences in Average Contract Size
- Reflects relative differences in Average Rate Units

Cost-neutrality Adjustment

- Applied so that final payments across all plans equal the aggregate cost using Standard-basis premiums

Sample Risk-Adjusted Rating Process – Basic Features

Plans quote Standard-basis premiums

- Premiums are based on the population currently enrolled in the plan (or expected to enroll for a new plan offering)

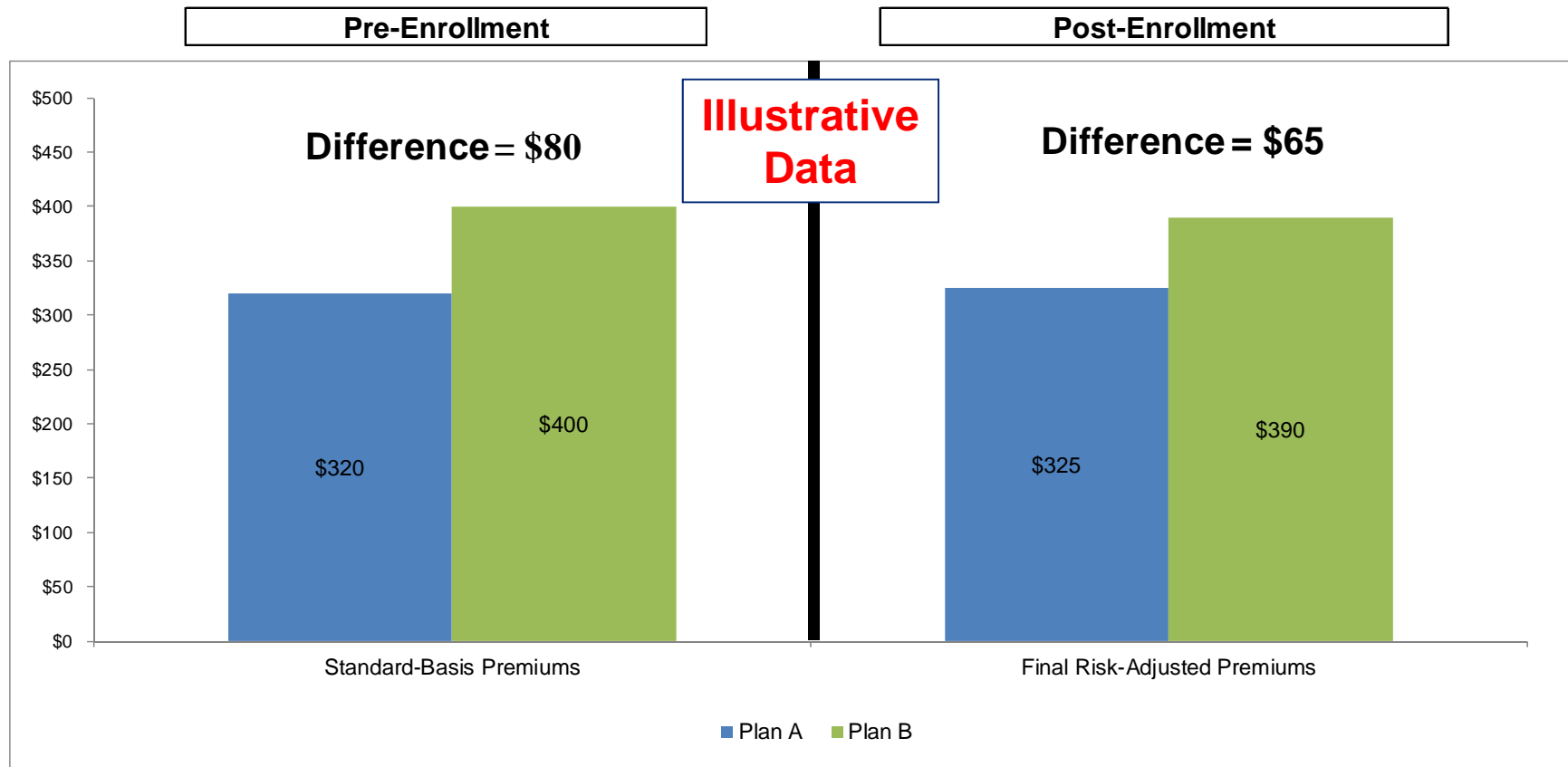
Standard-basis premiums are converted to Risk-neutral premiums

- Risk-neutral premiums reflect the average risk of the full covered population
 - Plans quote premiums assuming that they cover the average risk of the pool
- Using risk-neutral premiums to establish employer and employee contributions is intended to remove the effect of risk selection that is typically present in Standard-basis premiums
- Employers determine their contributions using the risk-neutral premium to “level the playing field” across plans, encouraging employees to choose a plan based on the plan's efficiency and design rather than the health status of members enrolling in the plan

Risk-neutral premiums are converted to Final Risk-Adjusted premiums

- Final Risk-Adjusted premiums represent the final premium paid to each plan, after adjusting premiums to reflect the actual risk enrolled in each plan
- Mitigates the additional conservatism plans might otherwise include in their quotes since plans know they will be paid for the risk they enroll

Sample Risk-Adjusted Rating Process – Results



- The conversion from Standard-basis premiums to Final Risk-Adjusted premiums results in payments to plans that reflect the actual risk they enroll
- This discourages plans to include a "risk load" in their premiums